Maintaining progress

"Capita is a much better business than it was at the start of the transformation, with stronger positions and improved growth prospects."

Jon Lewis
Chief Executive Officer

We started 2020 expecting to continue to strengthen the business operationally and to deliver more evidence of improvement – to be reflected in modest revenue growth and significant free cash flow generation.

We continued to make progress with many aspects of our transformation, but the impact of Covid-19 set us back and increased some of the challenges we faced.

I am pleased with our operational response to the pandemic, prioritising our colleagues and ensuring we could continue to deliver for our clients. The majority of our revenue has been resilient and we took decisive cost and cash action to manage the impact where it affected us. I do not believe we would have achieved this without the progress made in strengthening Capita over the preceding two years.

Adjusted revenue
£3,181.2m
(2019:£3,501.0m)

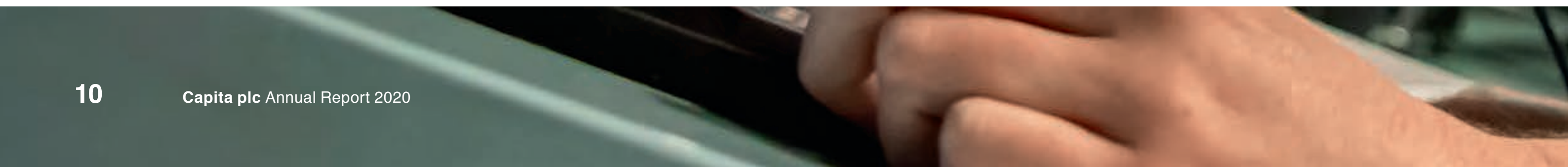
Adjusted profit before tax
£65.2m
(2019:£197.7m)

The fall in revenue and profit due to Covid-19 has put pressure on our balance sheet. But our cash preservation initiatives ensured that we met our covenant obligations, with net debt significantly better than at the end of 2019. We also took the decision to accelerate strategic actions to provide further financial support and dispose of non-core software assets, including Education Software Solutions (ESS), which sold for initial proceeds of £299m.

Despite the challenges of 2020, Capita is a much better business than it was at the start of the transformation, with stronger positions and improved growth prospects. With a more solid operational foundation in place, we are now moving onto the next phase of our transformation plan to 'simplify, strengthen and succeed'. We will be consolidating our current structure into three divisions. This comprises two core divisions – Capita Public Service and Capita Experience – focused on specific client needs and distinct markets where we know we can win. We will also have a third, enlarged portfolio of non-core businesses we intend to exit in due course; and a smaller overhead, generating additional long-term cost savings.

With respect to the balance sheet, our focus in 2021 is to ensure that we meet our upcoming debt maturities of £440m over the next two years, and put in place a longer-term financing solution. We have therefore started the process to extend our revolving credit facilities and we are targeting gross disposal proceeds of at least £700m, comprising £200m from three non-core disposals currently under way, and ESS proceeds of £299m that we have now received, with another £200m to come thereafter. Further support comes from benefits of the planned new structure and lower 'below the line' cash costs. We plan to issue longer-term debt when market conditions allow.

Our simpler new structure will support our inflection to sustainable cash generation in 2022 – as we continue to build a more focused, client-centric and streamlined business.



“With a more solid operational foundation in place, we are now moving onto the next phase of our transformation plan.”

Better outcomes

We have been chosen to transform and modernise the Royal Navy’s shore-based training across 16 sites in the UK as the lead partner in a consortium called Team Fisher. The contract, worth an estimated £1bn over 12 years, will see us leading the delivery of the new training programme, utilising our expertise in transformation, learning and the delivery of complex, technology-enabled defence projects. We are partnering in the consortium with Raytheon UK, Elbit Systems UK, and Fujitsu, as well as with several smaller British suppliers.

> "Our priority throughout the Covid crisis has been to protect the welfare and safety of our colleagues."

Financial results

Our financial performance in 2020 was significantly affected by the impact of Covid-19, despite the resilience of our operational response. To protect the business we took action to save a further £122m and, as a result, we were able to meet our covenant obligations at the year end and reduced net debt to £1,077.1m.

Adjusted revenue[1,2], fell by 9% during the year to £3,181.2m (2019: £3,501.0m) as a result of the impact of Covid-19, particularly on our transactional businesses such as Capita Travel & Events and Pay360, as well as due to prior-year contract losses in areas such as local government. This was partially offset by encouraging contract renewals and wins, as well as Covid-related work, mostly for the Government.

Adjusted profit before tax[1,2] decreased to £65.2m (2019: £197.7m), reflecting the loss of high-margin Covid-impacted transactional revenue and revenue from lost contracts, mitigated by a combination of £145.2m of planned transformational cost savings and £122m of cost and cash preservation taken in response to the pandemic. Including the impact of restructuring costs and accounting adjustments, reported loss before tax was £49.4m (2019: £62.6m loss). Reported earnings per share was (0.41)p (2019: (4.18)p).

Our strong cash performance in the year included strong working capital management and other short-term measures taken to protect the business, with around £50m expected to be sustainable. Adjusted free cash flow[1] increased to £238.6m (2019: £23.2m outflow) as we improved cash from trading operations, reduced capital expenditure significantly, and from strong client cash collection. The overall improvement in net debt was boosted by cash preservation benefits such as the £118.8m VAT deferral, offsetting cash costs of restructuring of £64.1m. Net debt at 31 December was £1,077.1m (2019: £1,353.2m) and we were well within the covenants.

Net debt

£1,077.1m

(2019: £1,353.2m)

Response to Covid-19

Our priority throughout the Covid-19 crisis has been to protect the welfare and safety of our colleagues and I would like to thank them all for their dedication. In February 2020, we set up a pandemic planning team and, within a few weeks, we had successfully mobilised 85% of our people to work from home, while ensuring we had secure workplaces for key workers who needed them.

Reflecting the critical nature of many of the services we provide to our clients, most of our revenue remained resilient. We delivered client services on a remote basis, building software and digital platforms, managing IT solutions and shifting to remote provision. However, we have been significantly affected in areas such as our travel business, and where our work is transactional and therefore affected by lower economic activity.

Offsetting this impact, we secured c.£100m of Covid-related business in 2020, including providing 1,200 contact-centre workers to a Government department and sending 11.2 million letters to the vulnerable on behalf of the NHS.

We won work in the private sector, where our resilient delivery model and onshore location meant we could offer services to key retail and telecoms clients that some of our major competitors could not.

We implemented a range of cost-saving initiatives to mitigate the revenue impact of the pandemic, sustaining these through the second half of the year and into 2021. We achieved £122m of savings in total, including discretionary expenditure of £64m, staff-related savings of £48m, and £10m mainly in variable property costs, as we temporarily closed 168 of our 294 properties at the height of the first lockdown.

We have also participated in the Government's VAT deferral scheme, benefiting the Group by £118.8m; postponed £56.7m of scheduled additional pension contributions; and entered into receivables financing arrangements. We expect these temporary cash saving measures to be paid back over the next 12 months.

Our experience with Covid-19 has enabled us to take steps to sustain some of the benefits and cost savings, mainly in travel and property.

Operationally, we have demonstrated to clients that remote working can be secure and productive, while maintaining our service KPIs. This has given fresh impetus to rationalising our property footprint. We have permanently closed 11% of our floor space in 2020, including our head office in London. We are now moving to a more flexible workspace model, allowing collaboration when needed but also recognising that our people want to spend more time working at home than before the pandemic. We plan to reduce office space by another 15% in 2021.

Responsible business

Being a responsible business continues to be a fundamental part of Capita's strategy. Putting our purpose – to create better outcomes – at the centre of all we do will benefit all of our stakeholders in the long term and has helped improve our reputation sentiment with external stakeholders.

In 2020, we delivered on our commitment to pay our UK employees the real living wage as a minimum. Our employee engagement continues to make progress, although there is clearly much more to be achieved. The employee net promoter score (eNPS) maintained its upward trajectory, increasing by seven points during the year and up 21 points since 2018.

We value our relationships with our suppliers, spending £2bn in 2020 with more than 24,540 direct suppliers in 87 countries. We pay 95% of our suppliers in 60 days or less, in line with the Government's prompt payment code. We are

1. Refer to alternative performance measures (APMs) on pages 204-206.
2. Adjusted results for both 2020 and 2019 exclude Education Software Solutions (ESS) as it is a business exit at 31 December 2020. ESS adjusted revenue and adjusted profit before tax in 2020 were £90.6m and £51.3m respectively. Covenant calculations adjust for ESS being excluded from EBITDA.

> "Our eNPS increased by seven points."

now looking to strengthen relationships with smaller suppliers.

Throughout 2020, we maintained our focus on our environmental impact. We reduced our carbon footprint by 40%, as we reduced travel and vacated offices. We have published our first statement on climate-related financial disclosure in our 2020 Responsible Business report and, in February 2021, we were accredited by the Science-based Target Initiative for our company carbon reduction targets, which will form the foundation of our commitment to get to net zero.

Transformation: building for revenue growth

Our revenue each year comes from a combination of longer-term, committed contracts that we report in our order book, framework contracts whose volumes are variable (but usually reliable), and transactional revenue that is won in-year.

While our target to grow revenue for the first time in many years was significantly affected by the pandemic, our track record of winning business showed tangible signs of improving during 2020, as we saw the first benefits from our investment in our clients, our structure and our capabilities.

Total contract value (TCV) won in the year was £3.1bn, £233m more than in 2019, which included framework and transactional wins. This represented 8% growth in TCV, or 11% in our core divisions (excluding Specialist Services). Our contract renewal rate of 90%, based on further improved client relationships, was a key driver. We have started 2021 strongly, with a £1bn contract to train the Royal Navy for the next 12 years. As would be expected, we also lost some contracts that impacted the second half of 2020 and will have a further impact in 2021.

The Group's order book declined to £5.9bn in 2020 (2019: £6.7bn), with £2.4bn recognised as revenue in the year and £1.6bn won in order book-qualifying revenue. Book-to-bill has increased from 0.79x to 0.94x on a Group basis and, following the win of the Royal Navy training contract in January 2021, this has now risen to 1.26x.

An increasing amount of Capita's revenue comes from framework and transactional revenue. Revenue won that was recognised in 2020 (in-year revenue) was flat at £1.2bn, despite the significant Covid-19 impact. Customer Management and Government Services were particularly strong, increasing by 72% and 92% respectively, benefiting from: Covid-related work; extensions for Transport for London (TfL); and big framework wins, such as a renewal for a European telecoms client.

Better structured with the right tools

As set out in 2018, our transformation growth strategy has been to win work through improving the capability and discipline in our sales function. We are now leveraging our new customer relationship management (CRM) platform better, giving us more insight and capability to predict future revenue. During the year we refined processes and the quality of our pipeline data, impacting pipeline in Q1 2020. We are winning more of the right work through the discipline of our contract review committee (CRC). In 2020, we maintained an average double-digit margin on the bids processed by the CRC, although with a slightly lower-margin mix of work.

Focusing on the client

The way we sell and the way that clients want to engage has been changing. As we have simplified and strengthened across Capita, we have moved from selling one bespoke product to each client, to selling solutions based on standardised platforms and which bring people and products together from across Capita. We then use our sector and business insight to offer the right solution to a client need.

As we have invested in operational improvement, as well as offering more relevant and better propositions, we have seen strong support from our clients. We have seen another significant improvement in our customer net promoter score, which increased by 17 points from +15 to +32. In our top 20 accounts this focus translated into pipeline growth of 40%.

During 2020, we streamlined the portfolio to focus on high-value propositions, as we build our understanding of what, to whom, and where, we should be selling. As a result, during the year 80% of TCV sold derived from 20 value proposals, out of a total portfolio of around 120.

With stronger client perception and better propositions to sell, account management was a major part of our sales performance in 2020. 43% of our 2020 TCV was won from our top 20 client accounts. Notable wins during the year were the TfL congestion charge and ultra-low emission zone extension (£355m), the RPP army recruitment extension (£140m), a European telecoms client's new framework extension (£114m), and the Teachers' Pension extension (£60m).

Transition to consulting-led sales

A consulting-led business model remains a key part of our revenue growth proposition, securing pull-through transformational and delivery work, enabling us to move up the value chain, win more business and improve the margin mix of Group revenue. Despite being hit hard by Covid-19, consulting revenue in 2020 focused on a highly specialised team with deep expertise in government, financial services and critical infrastructure, alongside three core practice areas: data and AI; transformation; and cloud.

A significant example of a consulting-led innovative and data-driven client solution was for the Financial Services Compensation Scheme (FSCS). In the face of a surge of claims to the FSCS, Capita and the FSCS worked in partnership to design a solution using data, AI and automation to allow them to process regulated, highly-complex claims more quickly and accurately, at around 30% of normal cost and taking two years less than normal. Having built this platform, we see opportunities to use it in other regulated industries.

Our markets are also gradually changing in nature, away from traditional business process outsourcing (BPO) to higher value business process services (BPS) and business process as a service (BPaaS). As a market leader in UK Government BPS, where the solution is delivered through a combination of people and

2. Nelson Hall/Tech Market View
3. Tussell March 2020

a bespoke digital platform, we are now investing in BPaaS capabilities, which is a standardised, process-specific solution deliverable to many clients.

Consulting and transformation revenue comprised just over 15% of total Group revenue won in 2020. We expect to improve both margins and cash generation by increasing this type of revenue, as well as doing more BPS and BPaaS work.

Market positioning
Supporting the more client-focused approach, we are leveraging our strong market positions to bring more insight into our specific markets than competitors.

Capita is one of the biggest IT services suppliers[3] to the UK Government which spends around £1bn[4] each year with us. Through improved contractual delivery, we now have a stronger relationship with the Government at a time when they are increasingly targeting investment in digital services and IT infrastructure. We also have a strong private sector position as the biggest customer experience partner in the UK, with specific expertise in the financial services, telecoms and utilities sectors. When we bring our understanding of complex solutions together with specific digital capabilities and combine them with our IT ecosystem partners such as Microsoft Azure, AWS and Cisco, our competitive position is now very strong.

Our better service delivery, investment in digital and IT capabilities, and more targeted marketing activities have all contributed to an improved market reputation with existing and potential clients in our chosen markets.

Sales outlook
The outlook for 2021 is promising, with a strong unweighted pipeline of £9.7bn (2019: £8.0bn), out of a total unweighted pipeline of £18.2bn (2019: £16.9bn), including a big increase in Government Services. It also includes contract bids that were delayed from 2020, such as the Royal Navy training contract which has now been won.

Transformation: reducing cost and targeting margin increases

We have continued to target and deliver significant, sustainable cost reductions, through greater efficiency and structural 'cost-out' opportunities. In 2020, we secured a further £145.2m of transformation cost savings (4% of the total cost base), taking the total across the last three years to £305m of sustainable savings. This is in addition to the £122m of Covid savings in 2020.

"Better service delivery, investment in digital and IT capabilities, and more targeted marketing activities have all contributed to an improved market reputation."

Contractual targets reached
90.3%
(2019: 91.4%)

Operational excellence and improvement
Despite the pandemic, we maintained our high level of service KPIs at 90.3% for 2020 (2019: 91.4%), including slightly better year-on-year performance in Customer Management, Government Services and People Solutions. This contributed to further improving our service credits, which reduced from £11m in 2019 to £4m in 2020.

We also significantly reduced the cash drag from major contracts, in particular in Government Services. The number of operationally and financially challenged contracts have reduced during the past two years from 16 to two (PCSE and Electronic Monitoring), where we expect to resolve key outstanding issues in 2021 and deliver significant benefits in 2022.

We are now also better at delivering large transformation projects. On RPP, we delivered another year of high KPI achievement; and our performance on the new Defence Fire and Rescue contract was exemplary, with all operational KPIs delivered on target, good cost and cash performance, and with additional revenue from contracts won to work at six more Ministry of Defence sites during the year.

We saved £73m in 2020 simply by doing things better, including from the benefits of operational maturity, process improvement, reducing our cost of poor quality and reducing margin erosion through performance failures.

Structural optimisation
One of the major objectives of the transformation has been the simplification of a highly complex and inefficient organisation. Leveraging data from our new HR platform, we have optimised structures to align with our target operating model, delivering efficiency and overhead savings of £25m in 2020 and we see similar opportunity in 2021.

Technology
We are making significant technology savings through better governance, major efficiencies driven by consolidation of resource from across the Group, and through associated third-party procurement savings as we consolidated our supplier base. These were £30m in 2020 and we have significant further opportunity in 2021.

We are bringing all of our IT services together to be managed in one place, giving clarity of management and more efficient use of resource, with lower future maintenance and investment costs. We also made further progress in consolidating our software development resource from across the divisions under the umbrella of the digital development centre in the UK and India.

Group and overhead costs
We accelerated our property consolidation programme, closing 49 offices in 2020 and reducing the office footprint. This delivered savings of £11m in the year, with an annualised run rate of £25m in 2021. Procurement savings also generated £4m of cost savings during the year, focusing on scale benefits, in particular as we consolidated previously fragmented third-party purchasing behaviours.

Better outcomes

We signed a contract with the Department of Education to continue the administration of the Teachers' Pension Scheme. The extension, which is due to start in October 2021, is worth £60m over four years. We will continue to deliver a fully integrated administration service for more than two million TPS members which includes the collection of contributions from over 11,200 employers, and the calculation and payment of pensions to more than 700,000 pensioners and beneficiaries.

Next phase of the transformation

Over the past three years we have improved governance, addressed inefficiency, and focused on historical underinvestment and on delivering better outcomes for our clients. Capita is now a simpler business with a stronger operational platform to underpin its future development than it was in 2018. Last year we announced the disposal of our Specialist Services division, which is delayed but ongoing, as well as announcing our intention to dispose of non-core software products, starting with Eclipse and ESS. Structurally, our core business is now more orientated to growth markets and focused on our clients.

With this stronger foundation in place, we are now moving onto the next phase of our transformation, consolidating down to three divisions: two core divisions – Capita Public Service and Capita Experience – focused on distinct market and client needs and a third Capita Portfolio division. This will comprise an enlarged portfolio of valuable but non-core businesses of which we are not the best owner and which we intend to exit when appropriate, with proforma revenue of around £700m.

We now have a clearer insight into where we can win, with most of our 2020 contract wins in clearly defined and focused areas – in specific parts of the UK Government market and in our core Customer Management industries. Both Public Service and Experience will adopt our 'consult, transform, deliver' business model with an increasing focus on digital transformation work. This structure will in turn drive out complexity and require a smaller, leaner Group overhead, from which we expect to save £50m on an annualised basis from 2022.

Public Service will integrate and simplify our offering to government, currently spread across four divisions, to focus on addressing their need to implement policy, transform productivity and improve citizen experience. The UK Government market is currently worth around £69bn. The fastest-growing parts of that, at around mid-single digit CAGR growth, are business process and technology-enabled services. As the number one strategic supplier of IT and software, Capita is already well positioned in this large and growing market, with a 2021 unweighted pipeline of £3.5bn. The proforma revenue of this division is expected to be around £1.2bn.

Experience will bring together our experts in designing, transforming and delivering frictionless customer experiences for blue-chip clients, including our regulated businesses, and a number of assets from three of the existing divisions. The global market is worth around £56bn and expected to grow at around 5% pa for the next three years. Currently one of the customer experience market leaders in the UK, and with a solid foothold in Germany and Switzerland, Capita has an opportunity to leverage its sector expertise, digital ecosystem and global delivery centre to become a pan-European leader. The proforma revenue of this division is expected to be around £1.3bn.

We plan to complete this next phase of the transformation this year and will provide more detail to the markets later this year.

> "Capita is now a simpler business with a stronger operational platform to underpin its future development."

Balance sheet

Our focus in 2021 is to address our upcoming debt maturities and put in place a longer-term financing solution.

Our plan at the beginning of 2020 was that net debt would increase slightly, before the disposal of the Specialist Services portfolio, in order to complete key elements of the transformation; but thereafter sufficient sustainable free cash flow would be generated to allow us to reduce headline net debt to EBITDA to within our target range of 1x to 2x (pre-IFRS 16). We had also planned a bond issue to extend our debt maturities. We were, however, unable to do either of these in 2020.

Instead, we protected the balance sheet through successful cost and cash preservation and the bringing forward of our plans to dispose of non-core software products. We repaid £218.4m of maturing debt, remained well within financial covenants at both the half year and full year, and reduced net debt through a combination of good cash management, disposal proceeds and the deferral of VAT and pension payments.

In the short term, our priority is to lengthen our current debt maturity profile as our free cash flow strengthens and to continue to be able to invest in our business.

However, we face significant short-term loan note maturities, with £440m due over the next two years. We plan to address this as follows:

- We recently received proceeds of £299m from the completion of the ESS disposal, which provides £220m of available liquidity, with a further £45m contingent on CMA clearance of buyer Montagu's subsequent transaction with ParentPay.
- We expect to renew and extend the maturity of our revolving credit facility.
- We are continuing to dispose of non-core assets, with three processes currently under way: namely our 'blue light' emergency services software; our specialist insurance businesses in partnership with Artificial Labs; and our Axelos joint venture with the UK Government, with combined expected proceeds of at least £200m. We anticipate proceeds to come through in the second half of the year. Further non-core disposals are expected to realise around £200m, including from more off-the-shelf software assets, as well as Specialist Service businesses that will be sold once recovery from the Covid crisis is well established.

We plan to put in place longer-term debt funding solutions, likely to be later in the year and subject to market conditions.

Outlook

Despite national lockdown through Q1, we are still targeting our first year of organic revenue growth for six years.

We plan to deliver improving profitability and cash flow from trading operations, offset by reversal of VAT savings, pension commitments and significant ongoing restructuring charges.

We are targeting disposal proceeds of £700m, with £500m in 2021.

Our new simpler structure supports inflection to sustainable cash generation in 2022.

We are continuing to build a more focused, client-centric and streamlined business, in order to deliver improving returns to investor.